

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2013

FISCAL ANALYSIS MEMORANDUM

[This confidential fiscal memorandum is a fiscal analysis of a draft bill, amendment, committee substitute, or conference committee report that has not been formally introduced or adopted on the chamber floor or in committee. This is not an official fiscal note. If upon introduction of the bill you determine that a formal fiscal note is needed, please make a fiscal note request to the Fiscal Research Division, and one will be provided under the rules of the House and the Senate.]

DATE: May 27, 2014

TO: House Finance Committee

FROM: Rodney Bizzell
Fiscal Research Division

RE: Senate Bill 786 (Fourth Edition)

FISCAL IMPACT					
	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> No Estimate Available		
State Impact	FY 2014-15	FY 2015-16	FY 2016-17	FY 2017-18	FY 2018-19
Part IV	No Fiscal Impact				
Part V	No Estimate Available				
Part VI	No Estimate Available				
Part VIII					
Sec. 29 (Attorney Position)	\$ 109,424	\$ 110,170	\$ 111,151	\$ 112,771	\$ 114,093
Sec. 30	No Estimate Available				
State Positions:	1.0				
NET STATE IMPACT	\$109,424.0	\$110,169.9	\$111,150.6	\$112,770.7	\$114,092.8
PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Environment and Natural Resources; Department of Revenue; Department of Justice; Department of Transportation, Administrative Office of the Courts EFFECTIVE DATE: Effective when law except as otherwise provided. TECHNICAL CONSIDERATIONS: Yes - See Technical Considerations Section					

BILL SUMMARY:

PART IV. CREATE OIL AND GAS COMMISSION AND RECONSTITUTE MINING COMMISSION

SECTIONS 4, 5, and 6 of the bill would, effective July 31, 2015, reinstate the Mining Commission (to consist of 7 members) and establish the Oil and Gas Commission (to consist of 9 members) as separate entities. The terms of all members serving on MEC would expire on July 31, 2015, and new appointments to the two distinct commissions would be required by August 1, 2015.

PART V. MISCELLANEOUS STATUTORY CHANGES RELATED TO SHALE GAS EXPLORATION, DEVELOPMENT, AND PRODUCTION

SECTION 8 of the bill would clarify requirements applicable to trade secrets received in connection with permitted oil and gas activities. Specifically, the provision would explicitly require: (i) MEC and DENR to retain trade secret information received; (ii) provision of the information to the Division of Emergency Management; and (iii) immediate disclosure of the information to first responders and medical personnel in the event of an emergency. Unlawful disclosure of information in violation of the provision would constitute a Class 1 misdemeanor. Appeals of decisions concerning trade secrets would be directed to the Business Court.

SECTION 11 of the bill would establish the fee due upon application to drill at \$3,000 for a first well on a pad and \$1,500 for each additional well on the same pad.

SECTION 14 of the bill would invalidate local ordinances that prohibit or have the effect of prohibiting oil and gas exploration, development, and production activities (including, those that would impose taxes, fees, or charges, or that regulate health, environment, or land use). The provision mirrors a statute preempting local government regulation of hazardous waste facilities (G.S. 130A-293). Specifically, the bill would invalidate ordinances that:

- Prohibit the siting of wells for oil and gas exploration, development, and production within any county, city, or other political subdivision.
- Prohibit the use of horizontal drilling or hydraulic fracturing for the purpose of oil or gas exploration or development within any county, city, or other political subdivision.
- Place any restriction or condition not placed by the statutes governing oil and gas upon oil and gas exploration, development, and production activities and use of horizontal drilling or hydraulic fracturing for that purpose within any county, city, or other political subdivision.
- In any manner are in conflict or inconsistent with the provisions of the statutes governing oil and gas.

SECTION 15 of the bill would:

- Require that all natural gas compressor stations associated with an oil and gas drilling operation be located inside a baffled building.
- Include a provision in the statutes governing oil and gas that prohibits the injection of wastes produced in connection with oil and gas exploration, development, and production, and use of horizontal drilling and hydraulic fracturing treatments to subsurface or groundwaters of the State by means of wells. Note that this is prohibited in another Chapter of the General Statutes, and is also prohibited under a draft rule pending with MEC.

- Provide that DENR may conduct an environmental compliance review of each applicant for a new permit for oil and gas activities in order to determine the extent to which the applicant, or affiliated entity, has substantially complied with the requirements applicable to any activity in which any of these entities previously engaged, and has substantially complied with federal, North Carolina, and other states' laws, regulations, and rules for the protection of the environment. DENR is authorized to deny an application for a permit if the applicant has a history of significant or repeated violations of statutes, rules, orders, or permit terms or conditions for the protection of the environment or for the conservation of natural resources as evidenced by civil penalty assessments, administrative or judicial compliance orders, or criminal penalties. DENR is also authorized to modify or revoke a permit, or require issuance of a new permit, based on substantial changes to environmental compliance history after a permit's issuance.
- Provide that no liability for trespass would arise from activities conducted for the purpose of seismic or geophysical data collection if a person has a landowner's written consent to enter the land for the activities, or if the person conducts seismic and geophysical data collection by undershooting from an off-site location and without physical entry to private land. If such activities are conducted through physical entry to land without a landowner's written consent, the violation would constitute a Class 1 misdemeanor. The language further provides that persons conducting seismic or geophysical data collection are civilly liable for any physical or property damage determined to be a direct result of their seismic or geophysical data collection activities, whether or not the seismic or geophysical data collection was conducted by undershooting the land at an off-site location or by physical entry to land as permitted by the landowner.

PART VI. SEVERANCE TAX

SECTIONS 17 THROUGH 19:

The bill would repeal North Carolina's current severance tax and levies a new severance tax on the removal of energy minerals from the soil and water of the State. The current State severance tax was enacted in 1945 and has not been modified since 1973. The current tax is five mills on each barrel of oil (the equivalent of .5¢ per barrel of oil) and one-half mill on each 1000 cubic feet of gas (the equivalent of .05¢ per 1000 cubic feet of gas). No tax is collected under the current law. The new severance tax would add condensates to the tax base, raise the tax rate on oil, and create a floating tax rate for gas.

Energy minerals are defined in the bill to include all forms of natural gas, oil, and related condensates. Thirty-three states, including North Carolina, currently impose some form of severance taxes on the extraction of oil and gas. Of the 33 states, 25 states impose a tax as a percentage of the value of the resource extracted, 7 states impose a tax on the volume extracted, and 1 state imposes a tax that is a combination of the two methods.

PART VIII. MISCELLANEOUS PROVISIONS UNRELATED TO SHALE GAS

SECTION 29 of the bill would repeal a provision that requires the Energy Policy Council to use an attorney assigned by the AG's office, and instead allow the Council to have legal support provided by DENR.

SECTION 30 of the bill would adopt the gas gallon equivalent (GGE) equivalent for compressed natural gas and the (diesel gas equivalent) DGE equivalent for liquid natural gas for the purpose of motor fuel taxation. The GGE equivalent is 5.66 pounds of compressed natural gas. The DGE equivalent of liquefied natural gas is 6.06 pounds of liquefied natural gas.

SOURCE: Research Division Summary

ASSUMPTIONS AND METHODOLOGY:

Part IV: Create Oil and Gas Commission and Reconstitute Mining Commission: Sections 3, 4 and 5 eliminate the 15 member North Carolina Mining and Energy Commission (MEC), establish a nine member North Carolina Oil and Gas Commission and reinstate the Mining Commission to consist of seven members. The terms of the all members of the MEC expire on July 31, 2015 and new appointments to the two new commissions would be required by August 1, 2015.

No fiscal impact: The net increase in commission members due to the changes above is one new member. Staff support for the commissions will be provided from existing staff of the Department of Environment and Natural Resources (DENR). No fiscal impact is anticipated from the changes to the commissions.

Part V: Miscellaneous Statutory Changes Related to Shale Gas Exploration, Development, and Production

Section 8.(a): This section creates a new section in Article 27 of Chapter 113, G.S. 113-391A, Trade secrets and confidential information determination; protection; retention disclosure to emergency personnel. The new statute creates a procedure for exempting certain information from disclosure as public records when it is obtained by the Department of Environment and Natural Resources (DENR) and the Commission(s) pursuant to their regulatory functions under Chapter 113, Article 27. An entity seeking to exempt that information from disclosure must make a “showing satisfactory to the Commission” that the disclosure would divulge “methods of process entitled to protection as confidential information pursuant to G.S. 132-1.2,” which is presumably referring to protection of trade secrets under G.S. 132-1.2(1). Disclosure is permitted to certain named entities in emergency situations.

New G.S. 113-391A(d) provides that knowing and unauthorized disclosure of information that the Commission determines to be confidential would, besides being a Class 1 misdemeanor offense, authorize a civil action for damages and injunctive relief for the unauthorized disclosure of “confidential information” under the new statute. This includes actions under Article 24, Chapter 66, trade secrets protection, but the proposed subsection (d) does not limit civil actions for unauthorized disclosure to that article.

New G.S. 113-391A(e) provides that any person aggrieved by the Commission’s decision that the information either is or is not confidential may appeal via a civil action filed in the Business Court for an “immediate hearing.” Although subsection (e) refers to an “appeal from Commission decisions,” the text of subsection (e) provides that an aggrieved party may “bring an action in Business Court” to appeal the decision, which appear to mean the filing of a civil action in

Superior Court. Subsection (e) provides that the Business Court has “exclusive jurisdiction” over action under this subsection and that such actions “shall be set down for immediate hearing.”

No Fiscal Estimate Available: The Administrative Office of the Courts (AOC) does not have any existing data upon which to estimate the number of civil actions for damages and injunctive relief may be brought due to this new provision

For civil actions under subsection (d), Article 24, Chapter 66 does not specify which trial division is the proper venue. If an action were filed in District Court, the workload impact on deputy clerk and District Court judge time would have an estimated average cost of \$395 per case. If heard in Superior Court, the workload impact for deputy clerk, Superior Court judge, and court reporter positions would have an average cost per disposition of \$1,042. Each petition would be accompanied with either a \$150 civil District Court filing fee or a \$200 civil Superior Court filing fee. From this fee, the General Fund receives either \$129.40 or \$179.40 per case. In addition, there is a \$30.00 service fee for each item of civil process served by the sheriff, of which ten percent (\$3.00) is remitted to the General Fund as part of the collection assistance fee. Complex cases handled in Business Court would be assessed an additional \$1,000 upon assignment. There is no available data to estimate the percentage of cases that will be considered indigent for purposes of fee collection.

For civil actions under subsection (e), cases will be heard in Superior Court have a workload impact for deputy clerk, Superior Court judge, and court reporter positions. The cost per disposition for the average civil superior case is \$1,042. Each petition for appeal would be accompanied with a \$200 civil superior court filing fee. From this fee, the General Fund receives \$179.40 per case. Business Court cases are assessed an additional \$1,000 upon assignment.

Section 11: This section reduces the fee due upon application to drill, from \$3,000 for each well drilled, to \$3,000 for the first well on a pad and \$1,500 for each additional well on the same pad.

No Fiscal Estimate Available: The fiscal impact on the amount of revenue generated from the permit application fee depends on the number wells to be drilled. This number is unknown at this time.

Section 14: This section would invalidate local ordinances that prohibit or have the effect of prohibiting oil and gas exploration, development and production activities. It also sets out the procedure the Mining and Energy Commission must follow when petitioned by an operator whose proposed oil and gas activities have been prevented by a local ordinance.

No Fiscal Estimate Available: DENR noted that “considerable time” may be required to support the Commission’s findings of local preemption when petitioned; however, the Department was not able to quantify this requirement. Without knowing the number of petitions to be filed or the extent to which to preempt the local ordinance, the fiscal impact can’t be determined.

Section 15: This section, among other things, requires DENR to conduct an environmental compliance review of each applicant for a new permit for oil and gas activities in order to determine the extent to which the applicant has substantially complied with federal, North Carolina, and other states' laws, regulations, and rules for the protection of the environment. It sets the environmental compliance review at a minimum of five years but allows the Department to establish a longer period of time. It provides the Department with the discretion to determine whether the environmental compliance review extends to the history of the parents, subsidiaries, or other affiliates of the applicant. It directs the Department to determine the scope of the review and to determine when the applicant has "substantially complied" with the requirements applicable to any activity in which the applicant, or affiliated entity, has previously engaged.

No Fiscal Estimate Available: The fiscal impact is dependent on a number of factors, none of which are known at this time, including: 1) the applications to be received, 2) the number of affiliated entities subject to the review, 3) the scope of the review, and 3) the definitive period of time covered by the review.

Part VI: Severance Tax

Sections 17 – 19: These sections would repeal North Carolina's current severance tax on the removal of energy minerals from the soil and water of the State, and would create a new severance tax structure for the extraction of oil, gas, and related condensates. The current tax is five mills on each barrel of oil (the equivalent of .5¢ per barrel of oil) and one-half mill on each 1000 cubic feet of gas (the equivalent of .05¢ per 1000 cubic feet of gas). No tax is collected under the current law. The new severance tax would add condensates to the tax base, raise the tax rate on oil, and create a floating tax rate for gas.

Energy minerals are defined in the draft to include all forms of natural gas, oil, and related condensates. Thirty-three states, including North Carolina, currently impose some form of severance taxes on the extraction of oil and gas. Of the 33 states, 25 states impose a tax as a percentage of the value of the resource extracted, 7 states impose a tax on the volume extracted, and 1 state imposes a tax that is a combination of the two methods. This proposal creates a severance tax structure that treats oil and condensates, marginal gas, and natural gas differently. In addition, the rates charged generally increase in the out years. For a complete breakdown of the tax rates included in this proposal, see the bill summary.

No Fiscal Estimate Available: It is impossible to estimate the level of severance tax revenues that may be generated as a result of this proposal. First, the natural gas reserves in North Carolina remain untested, so it is unclear how much recoverable gas exists. Second, it is unclear what price points would make the natural gas and related condensates in North Carolina economically recoverable. Third, given the recent volatility in natural gas and condensate commodity prices, it is unclear when the market will justify substantial extraction activities in North Carolina. As a result of these factors, it is unclear if substantial exploration or extraction activities will occur in North Carolina within the next five years. In addition, this proposal creates a variable rate structure that is tied to the delivered market price for natural gas, further complicating any revenue projection.

Part VIII: Miscellaneous Provisions Unrelated to Shale Gas

Section 29: This section repeals a provision that requires the Energy Policy Council to use an attorney assigned by the Attorney General’s Office, and instead allows the Council to have legal support provided by DENR.

Fiscal Impact: The Energy Policy Council was transferred from the Department of Commerce to the DENR effective July 1, 2013. In past ten months, the Department has reassigned two attorneys who have worked approximately half time to support the Council. It is anticipated that the Council will need this level of legal support for the foreseeable future. An additional Attorney position budgeted at the middle of the salary range is \$85,312, or \$109,424 with benefits.

Section 30. This bill allows compressed natural gas (CNG) and liquefied natural gas (LNG) to be taxed based on the pound equivalent of a gallon of gasoline.

No Fiscal Estimate Available: It is not known how much tax revenue from CNG and LNG that are used for transportation purposes are currently generated. The North Carolina Department of Revenue’s (DOR) motor fuel tax forms that track the type of fuel being taxed do not include a line for LNG reporting. DOR plans to add a line to capture LNG taxes in the future. DOR captures CNG tax reporting in a line that includes propane use. North Carolina tax collections for propane/CNG are increasing. Tax collections have grown from \$399,000 in FY 2011-12, to \$675,000 in FY 2012-13, to \$880,000 in the first 10 months of FY 2013-14. It is not known how much of this tax collection is attributable to CNG sales, but it is assumed the majority of the tax is from propane sales.

Both CNG and LNG used for non-transportation purposes are taxable under the North Carolina sales tax. It is not known how much revenue is generated from these taxes.

SOURCES OF DATA: Department of Revenue; Department of Environment and Natural Resources, Administrative Office of the Courts

TECHNICAL CONSIDERATIONS:

Section 8.(a): AOC points out that there may be some procedural confusion by the language for “immediate” hearing in new G.S. 113-391(e). The Public Records Act, G.S. Chapter 132, also provides for “immediate” hearings and priority before the courts, but those actions occur within the regular trial divisions for which sessions are more frequent and with more flexible calendars. Unlike Chapter 132, the proposed subsection (e) does not indicate what relative priority these actions have in relation to other actions already scheduled before the Business Court.

Additionally, AOC finds that the proper venue for filing the action under subsection (e) may be uncertain. The Business Court is a special setting of the Superior Court and not a trial division unto itself. Cases are designated for the Business Court from already-filed actions in one of the two trial divisions from any of the 100 counties. For the purposes of venue and recordkeeping, the cases are treated as pending in the counties where they were originally filed rather than as actions in one of the three counties where the Business Court sits. The proposed subsection (e) describes “bring[ing] an action in the Business Court” but further provides that actions under that subsection would

proceed “in accordance with the procedures for a mandatory business case set forth in G.S. 7A-45.4.” It, therefore, is unclear if subsection (e) contemplates a filing directly with one of the three counties where the Business Court currently sits or filing in the county where the venue would otherwise lie, with the normal Notice of Designation filed under G.S. 7A-45.4(b) and routed to the Chief Justice for mandatory assignment of the case to one of the three Business Courts.

